HOUSE VIEW

THE ECONOMIC CYCLE WILL NOT DERAIL

BancaMarch

THE ECONOMIC CYCLE WILL NOT DERAIL

STRATEGIC POSITION

ASSET ALLOCATION

ASSET CLASS	-2	-1	NEUTRAL	+1	+2
LIQUIDITY		■			
FIXED-INCOME				■	
EQUITY			■		
ALTERNATIVE			■		

FIXED-INCOME	-2	-1	NEUTRAL	+1	+2
SOVEREIGN DEBT		■			
United States			■		
Euro			■		
CORPORATE BONDS				■	
Investment Grade				■	
High Yield			■		
EMERGING MARKET DEBT				■	
CONVERTIBLE BONDS			■		

EQUITY	-2	-1	NEUTRAL	+1	+2
EUROPE			■		
UNITED STATES				■	
EMERGING MARKETS			■		
REST OF WORLD		■			

ALTERNATIVE	-2	-1	NEUTRAL	+1	+2
LIQUID		■			
ILLIQUID				■	

CURRENCIES	-	NEUTRAL	+
DOLLAR		■	
POUND STERLING		■	

MACROECONOMIC OUTLOOK

Geopolitical uncertainty dampens animal spirits and will undermine growth...

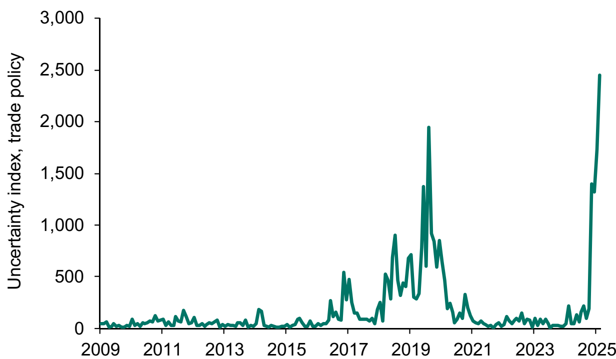
Trump has kept up a frenetic pace during his first two months in office and is big on threats and radicalism. While his choice of strategy is nothing new, the new administration is now openly talking about a "transition period" and is not ruling out the risk of recession, thus fuelling speculation that his economic policies could ultimately spell the end of the current expansionary state of the world economy.

A cycle now in its fifth year of life and which, over the past five years, has succeeded in shrugging off the turmoil left by the pandemic, the outbreak of war in Ukraine —causing the biggest inflationary shock since the 1980s—, and the highest interest rates we have witnessed since the beginning of the century.

These are turbulent times for sure, and in recent weeks all indicators of economic policy uncertainty have been skyrocketing (Figure 1), surpassing even the highs reached during the pandemic. The upturn in mistrust extends in particular to those countries directly embroiled in the "trade war" with the United States: China, Mexico and Canada were the first, although now doubts are now growing in Europe as well.

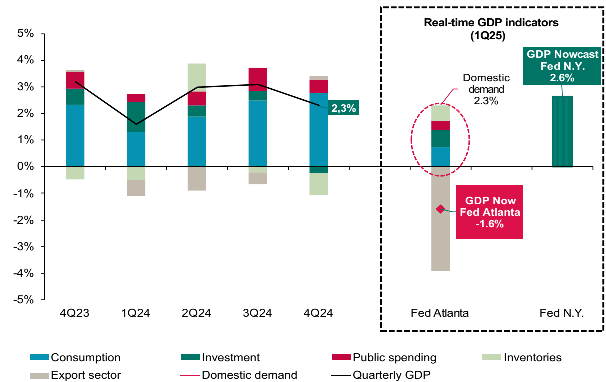
1. POLITICAL UNCERTAINTY RUNS RAMPANT

Sources: Baker, Bloom & Davis, Bloomberg, and Banca March



2. NOT MUCH DATA FOR Q1, THUS BIASING REAL-TIME MODELS (US GDP)

Sources: Baker, Bloom & Davis, Bloomberg, and Banca March



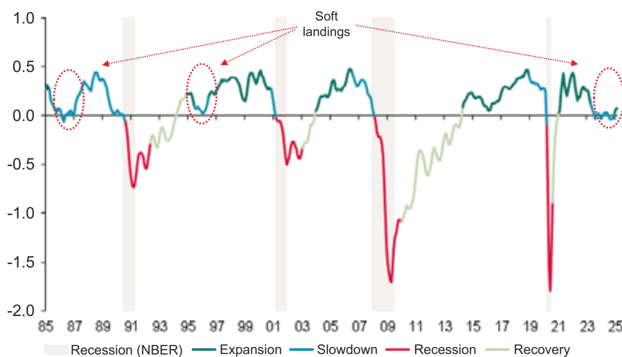
This confusing situation is beginning to feed through to macroeconomic publications and even to the real-time GDP indicators tracked by the Federal Reserves of the various American States (Figure 2).

The Atlanta Fed's GDP Now indicator dipped into contraction territory (-1.6%), sparking fears of an imminent recession. However, there are two key considerations that we believe should help to assuage this fear: first of all, this dip is actually a product of the sharp increase in the trade deficit in January, which was in turn due to the markets anticipating the tariffs and which we believe will not stick around in the coming quarters. US imports grew by 10% in the month and, notably, gold purchases accounted for 60% of the increase, with gold being a component that was not counted in the GDP calculation. The stockpiling of this precious metal has a lot to do with the fact that it is a readily storable commodity and, therefore, gold imports have been brought forward over fears of new tariffs. The second factor is that, if we look at other similar official real time indicators, such as that of the NY Fed, they happen to point in exactly the opposite direction, revealing GDP growth of 2.6% for this quarter.

… but the global economy will not come off the rails.

3. OUR INDICATOR IS SIMILAR TO OTHER "SOFT LANDINGS" IN THE PAST

Sources: Bloomberg and Banca March



In our view, what is clear is that, if this confusing and erratic tariff policy persists over time, the global economy will indeed feel the pinch, as these levels of uncertainty will ultimately put back private consumption and investment decisions.

However, our indicator of economic momentum in the United States shows no signs of a sharp downturn as the markets seem to be anticipating (Figure 3). Therefore, we believe that while the macroeconomic data are hardly buoyant, neither do they show signs of an imminent slump in economic activity.

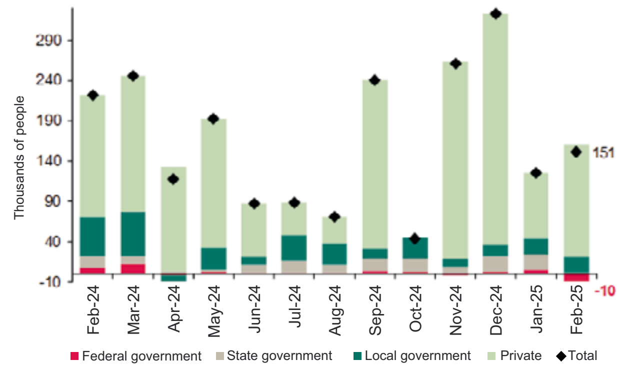
On balance, we reckon that the indicators point to a gradual cooling of job creation, but not the beginning of a period of private job destruction. The unemployment rate has been fairly stable since last September, at around 4.1% and, if we look at the last three months, the economy has created an average of 200,000 jobs, a figure that is even above the average for 2024 (167,000).

Layoffs are beginning to increase, though from a historically low level (the layoff rate is only 1%), with unfilled vacancies rising once again in January to reach 7.7 million, and still representing 1.1x the number of unemployed in the economy. A ratio that shows strong demand for employment.

On the negative side, the impact of the staff cuts carried out by the DOGE agency will take its toll on employment figures over the coming months. The federal government employs around three million people (just under 2% of the total workforce). Due to the hiring freeze, jobs in the federal public sector failed to keep up with the pace of layoffs, leading to a net loss of 10,000 jobs (i.e. 0.3% of all federal jobs). However, as shown in Figure 4, private job creation remained buoyant and more than offset the slump in public employment.

4. EMPLOYMENT HOLDS STEADY DESPITE HEAVY DOGE CUTS

Sources: Bloomberg and Banca March



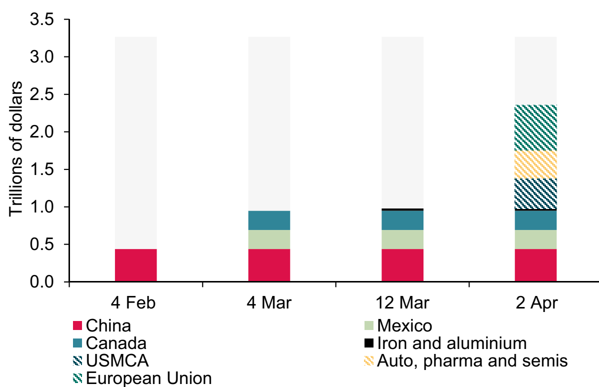
Trump's draconian threats are clouding the horizon, although a trade war is bad for everyone, which should prompt new negotiations...

The escalation of the trade war, with tariffs hikes happening left, right and centre, makes it difficult to anticipate what the end point will be when it will all finish.

Among the measures already implemented, perhaps the biggest are the 20 pp increase in tariffs on China and a 25% tariff on steel and aluminium. On top of all this, we have further threats of a 25% tariff on imports from traditionally allied countries (in some cases temporarily suspended, such as for Canada and Mexico, and in others, such as for the EU, with the date of entry into force put back until 2 April). The upshot is that, if all these rates go ahead, the United States would move to an average effective tariff in excess of 10%, tripling the pre-Trump levels and making it the highest since 1943.

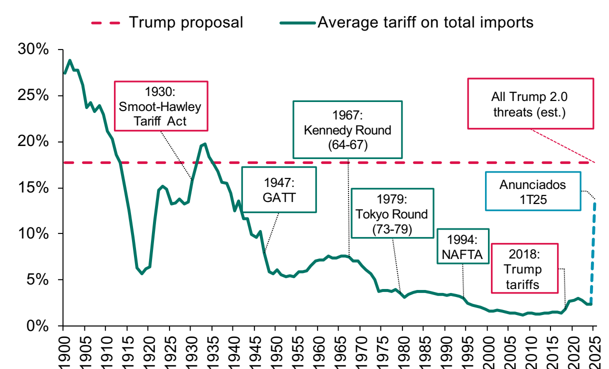
5. TIMELINE FOR POSSIBLE NEW TARIFFS(*)

Sources: International Trade Administration, Tax Foundation and Banca March



6. TRUMP STEPS UP NEGOTIATIONS

Sources: International Trade Administration, Tax Foundation and Banca March

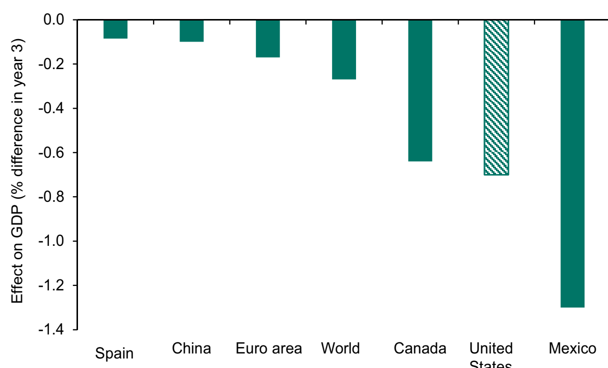


(*) For individual goods, the share of countries/regions that already have country tariffs has been removed.

Meanwhile, the other economies of the world have been shaping up retaliatory measures and this raises the spectre of a trade war scenario. While this tit for tat would ultimately be bad for everyone involved, in our view it is precisely this potentially negative effect on the global economy that should allow agreements to be reached that are less damaging for all sides. To give an example, a recent OECD simulation of the direct effect of a 10 pp increase in reciprocal tariffs would trigger a three-year GDP loss of seven tenths of a percentage point for the United States and at least half a percentage point for developed economies as a whole (Figure 7). In tandem, inflation would also rise by four to seven tenths of a percentage point.

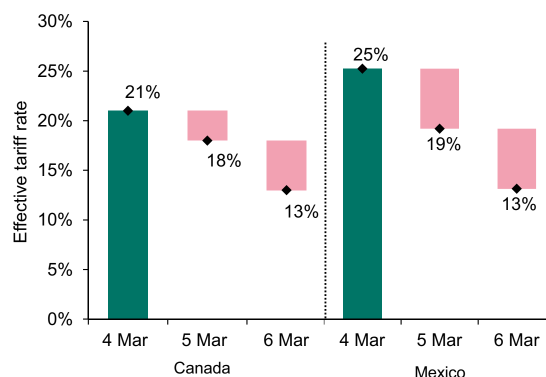
7. IMPACT OF TIT-FOR-TAT TARIFFS

Sources: OECD, O.E. and Banca March



8. TEMPORARY EXEMPTIONS FOR CERTAIN PRODUCTS HAVE LOWERED THE EFFECTIVE RATE

Sources: OECD, O.E. and Banca March



(*) 4 Mar (announcement of 25% tariff on Mexico and Canada; 10% on Canadian energy); 5 Mar (announcement of exemption on automobiles under USMCA); 6 Mar (announcement of exemption for all products under USMCA).

These numbers are intended as a yardstick but would illustrate only part of the potential negative effects of the current erratic tariff policy being pursued by the United States. For instance, this simulation does not include a further worsening in confidence among economic agents that will likely result from the current uncertainty over trade policy.

Moreover, this simulation omits details that will be decisive and that will change the effect of the tariffs due to bargaining power and, above all, because the tariffs will most likely not be universal, but rather targeted at specific products.

...What's more, the introduction of tariffs is not an end point: this month we have witnessed how the negotiations have succeeded in achieving more moderate rates than those initially threatened.

A good illustration of this can be seen in Figure 8, as the recent announcement of tariffs by the United States on its two neighbouring countries: after a month's delay, tariffs of 25% for both Mexico and Canada (with the exception of Canadian energy imports, which are taxed at 10%) came into force on 4 March. This would mean moving from almost 0% to effective average rates for all imports of 25% and 21% respectively.

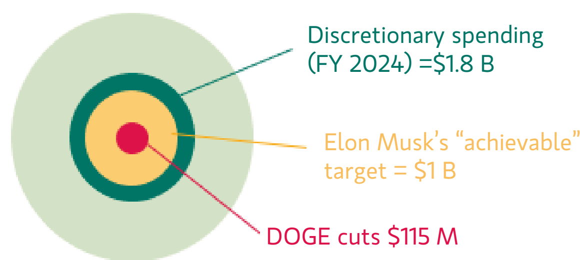
However, an exemption for automotive imports was announced the very next day, lowering the effective rate to 19% for Mexico and 18% for Canada.

And it didn't end there. On 6 March (just two days after the tariffs came into force), it was agreed that the 25% tariffs would apply only to imports on products that do not comply with the rules of the free trade agreement between the three countries (now USMCA, formerly known as NAFTA). This now brings the average effective rate of the tariffs to 13% for both Canada and Mexico, a fair bit lower than the 25% initially announced.

The Trump administration has started with the "worst bit": the spending and job cuts enforced by the DOGE. In practice, however, these actions will have only a limited impact in improving the balance of public finances.

9. DOGE CUTS

Sources: CBO, DOGE and Banca March



Chainsaw, a lot of fanfare, weekly emails to officials and layoffs, yet Musk's power to act is shackled. The new head of the DOGE has announced plans to slash $1 trillion in government spending. A figure that seems extremely optimistic, seeing as though the spending it could affect (discretionary spending, including defence) accounts for roughly $1.8 trillion, or $960 billion if we strip out defence. In other words, it would mean slashing more than 55% of these discretionary expenditures, which finance items as diverse as the administration of justice, education and transport. At the time of writing, the DOGE estimates savings of $115 billion, or 6% of discretionary spending. While the DOGE may succeed in making some kind of impact, it will not be enough to balance the budgets, as the power to achieve significant savings lies in the hands of Congress. In terms of GDP, total expenditure in 2024 was 23.4%, the fiscal deficit 6.6% and debt 123%, while the cuts made so far amount to just 0.4%.

The long-awaited tax cuts will come, though not yet.

For the time being, Congress is working on the tedious process of "budget reconciliation", allowing for changes in entitlement (mandatory) spending, revenues and the debt ceiling. Unlike the conventional method, 60 votes are not needed in the Senate, meaning they do not require the support of the Democrats. However, there are sizeable differences between the Republican members of Congress in both chambers, and so this process could drag out. While there is speculation of a final proposal arriving in the summer, in reality it could take until the end of the year, as the current tax cut law (Tax Cuts & Jobs Act, 2017) expires on 31 December 2025.

Looking back in time, the implementation of the TCJA of 2017 also required this mechanism. It includes deductions for individual income, though also tax relief for large companies. Once implemented, the maximum corporate tax rate was lowered from 35% to 21%. Trump promised during his campaign trail to drop it to just 15%. However, fiscal pressures could lead legislators not to cut as much as promised.

As things currently stand, the House of Representatives has completed the preliminary phase of extending the TCJA by approving its own draft budget on 25 February. In the document, it presents tax cuts of around $4.5 trillion over the course of a decade, coupled with increases in defence and border security spending of $300 billion. However, the spending cuts—estimated at $2 trillion over the same period—will only partially cover the tax cuts, effectively resulting in an increase in debt. Both houses of Congress will need to unify their proposals so that they are aligned with the same resolution.

Meanwhile, in the euro area, everything is pointing to a fiscal U-turn...

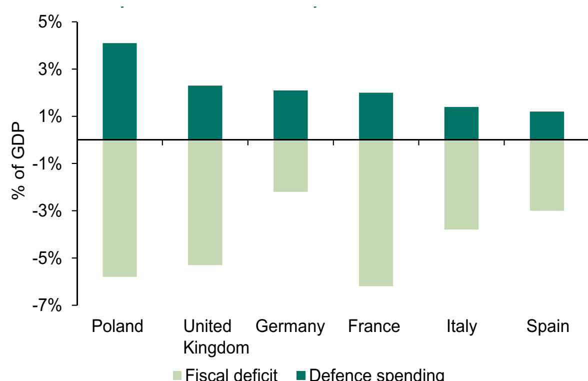
Without doubt, the uncertainty that this erratic trade policy is eliciting is a negative externality for the world economy, although the shock waves emanating from Trump's aggressive approach to negotiating have, in some cases, resulted in unexpected effects.

The dizzying sequence of events surrounding the peace talks with Russia has led to a historic shift in European economic policies, particularly in Germany, which has the greatest capacity to finance itself.

Following the suspension of US military aid to Ukraine, Europe has been exposed and emergency meetings between European leaders underline how delicate the situation now is for the wider continent. The European response has been swift and the European Commission has announced the "ReArm Europe" programme of a size only comparable to that rolled out during the pandemic. Its budget of €800 billion (equivalent to 4.5% of EU-wide GDP) will be used to boost defence spending and, in the process, kick-start the economy. While it is true that the programme has begun life with funding difficulties—more than 80% will have to be raised by the states themselves, which will inevitably push up financing costs—it is a clear sign of intent and is an additional factor in stimulating activity within the region.

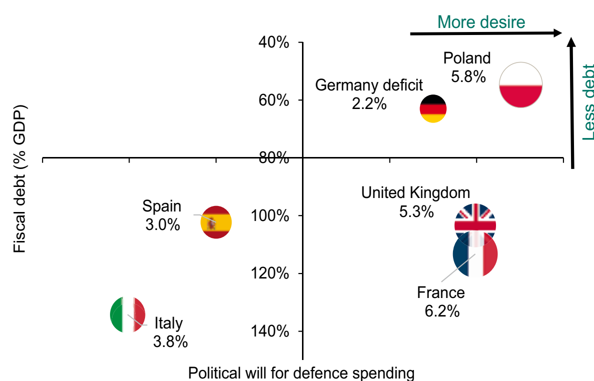
10. INCREASED SPENDING ON DEFENCE WILL DEPEND ON EACH COUNTRY'S PUBLIC ACCOUNTS

Sources: European Commission, NATO, Bloomberg and Banca March



11. FISCAL MARGIN VS. WILLINGNESS TO INCREASE DEFENCE SPENDING (*)

Sources: European Commission, NATO, Bloomberg and Banca March



(*) The size of the circles represents the deficit (% of GDP, 2024).

Not all economies of Europe will be able to push for more defence spending with the same ease, and even less so if the funding is to be dependent on the financial markets, as indeed presented by the European Commission. As we can see in Figure 11, the public accounts of France, with a deficit of over 6% and a debt of 113%, are a far cry from Germany's, whose deficit is close to 2% of GDP and whose public debt is among the lowest of the major powers (63% of GDP compared to over 120% in the United States and 251% in the case of Japan).

...which, on this occasion, will be headed up by Germany.

It is especially positive that the European drive for more joint fiscal stimulus has been supported by Germany. After five years of stagnation, with healthy public accounts and a new executive at the helm, Europe's economic powerhouse has decided to act. While the precise details of the stimulus they will ultimately seek to implement are still on the drawing board, the initial amounts being considered are fairly sizeable and certainly capable of boosting growth.

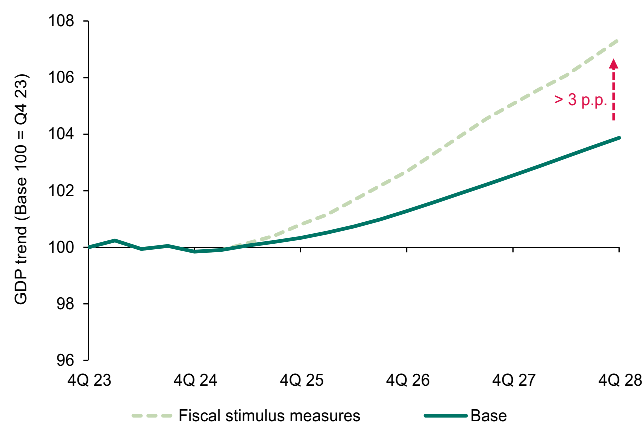
One of the main measures already agreed will be a €500 billion vehicle for infrastructure investment, which will mean mobilising 11.6% of GDP. Following recent negotiations with the Greens, this vehicle will have a longer timeframe (up to 12 years to implement), and of the total capital outlay required, some €100 billion will be channelled through the Climate Transition Fund and of the remaining €400 billion, the federal government will shoulder 75% and the states the remaining 25% (a further €100 billion). Historically, fiscal stimuli channelled through infrastructure have a fairly significant mid-term growth-enhancing effect. So if this time around we apply a conservative fiscal multiplier of 0.7x, we could see an additional boost to German GDP growth of over +0.6 p.p. per year.

The nation has also approved that defence spending above 1% of GDP be exempted from the debt brake. Assuming that Germany raises its defence spending to US levels (3.3% of GDP), this would mean mobilising a further 1.2% of GDP. In this case, we would be talking about a minor, though certainly not negligible, boost to growth: as most of Germany's military equipment is purchased outside the country, the additional boost will be smaller and would be somewhere between 0.2 and 0.5 p.p.

Aside from these measures, the stimulus may not stop there. In its election manifesto, Merz's party (CDU-CSU) advocated the need to lower corporate tax (currently over 30%, one of the highest in the OECD). If ultimately implemented, this measure would be a further boost to German companies. With the formation of the new Bundestag (Federal Parliament) due to take place in mid-April and the approval of new budgets expected before the end of July, there could be further developments in the first half of the year.

12. THE NEW PROGRAMMES WILL BOOST GERMANY'S GDP

Sources: O.E. and Banca March



Although we will need to await the finer details of all these measures, what is certain is that Germany has taken a resolute fiscal U-turn and we think it will be enough to boost growth in Europe's traditional locomotive.

In our scenario, which assumes a staggered implementation of both the infrastructure investment fund and increased defence spending (by 2027 they would be running at full capacity), we expect German GDP to rise by more than 3 pp compared to what was widely expected prior to the German elections.

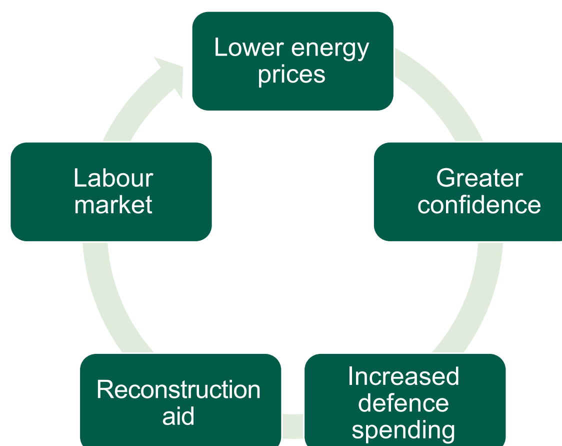
A "ceasefire" in Ukraine seems to be on the horizon, as a further factor boosting economic growth, especially in Germany.

Beyond concerns over the impetuous nature of the peace negotiations under way, in economic terms, the effects of a ceasefire in Ukraine would be clearly positive for the euro area and especially for those countries that are closest to the conflict, such as Germany, which stands to benefit from lower energy costs and will also be able to play a more prominent role in the reconstruction work.

The economic impact for Europe will come through five transmission channels (Figure 13), which together will have a distinctly positive effect on economic growth across the wider region.

13. A "CEASEFIRE" WOULD TRIGGER POSITIVE EFFECTS FOR THE EURO AREA

Source: Banca March



Only the inevitable reduction in the labour force, as Ukrainian refugees head back to their home country, can be seen as a possible brake. However, we expect this effect will be pretty modest: of the 4.5 million refugees, barely 40% would be actively taking part in the labour market (less than 2 million people). Even in Germany, one of the most exposed economies, the total number of refugees would account for just 1.1% of the total labour force, while in Spain this figure would drop to below 0.5%.

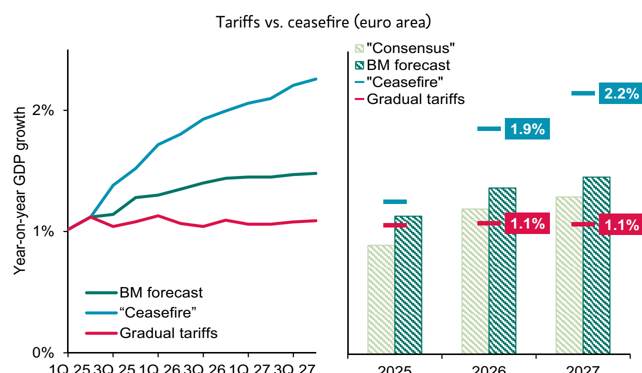
On a more positive note, lower energy prices and increased confidence among economic agents should serve to boost domestic consumption, while increased defence spending and reconstruction efforts should stimulate business activity in general, and investment in particular.

All in all, we believe that, should a lasting ceasefire be confirmed, the GDP outlook for the euro area should be raised.

Most notably, the positive impact of this new environment would even lead to an improvement in our projected scenario for 2025, pushing up the growth rate in the euro area.

14. OUR GRADUAL RECOVERY SCENARIO REMAINS INTACT

Sources: O.E. and Banca March



Although we will have to wait for the final outcome of the negotiations to obtain a clearer picture, we estimate that growth in the region should increase by 0.5% to 1% over the next two years under a "ceasefire" scenario, which points to a return to growth rates closer to 2% in the euro area as early as 2026, compared to the 1.4% we currently forecast, and also above the 1.2% expected by the market consensus and by the ECB itself in its March forecasts.

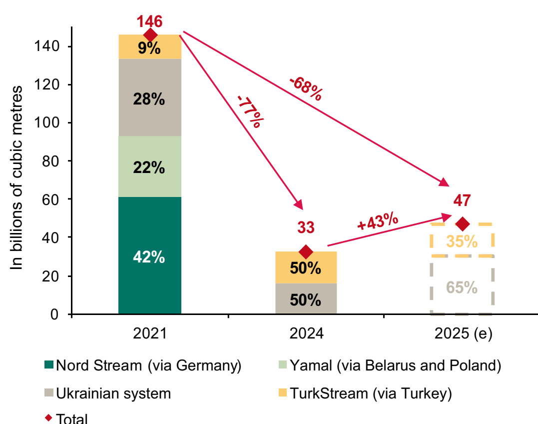
While a ceasefire in Ukraine would ease energy costs, Europe's dependence on outside energy will persist and the supply of gas will not be restored any time soon.

Prior to the invasion of Ukraine in early 2022, 20–25% of the gas reaching Europe came via pipelines from Russia (Nord Stream I, Yamal, TurkStream and the Ukrainian system). The subsequent closure of gas pipelines has forced Europe to reduce its gas consumption by 31% in the last three years and to import a large part of it by ship (25% today vs. 13% in late 2021), thus making it less reliant on Russia.

However, even if an immediate agreement with Ukraine were to be reached, gas would not flow as readily before the conflict because certain key pipelines are out of operation (Nord Stream I and II), while for others the agreements would have to be renegotiated (Yamal and Ukrainian system). Today, only TurkStream remains active, through which only 9% of Russian gas entered before the war.

15. EU: RUSSIAN GAS IMPORTS VIA PIPELINE

Sources: Bruegel, Eurostat and Banca March



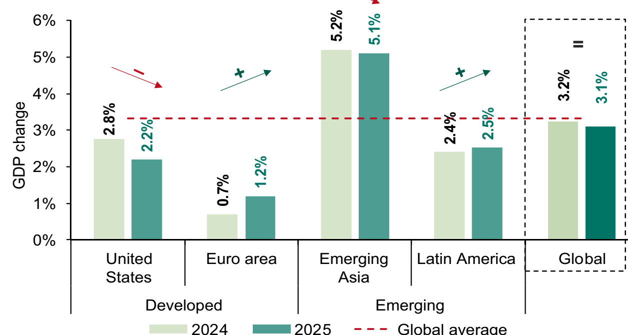
We believe that a peace agreement could lead to the reopening of the Ukrainian pipeline, which was active until late 2024 and could deliver five times more than TurkStream. Looking at 2025, and assuming that the 2024 level of imports via TurkStream is maintained and that, from April, the Ukrainian pipeline system is reopened with a level of imports similar to that observed in 2021, Russian pipeline gas purchases could increase by 43% to reach 47 billion cubic metres. However, this figure is still 68% below 2021 levels.

In 2025 we will remain within an environment of unbalanced cycles: The US economy is slowing, while the outlook for Europe and China is more upbeat.

This macroeconomic scenario—more uncertain than what it was just three months ago—has promoted us to slightly lower our global GDP outlook, although we maintain our view that global growth will not come to a screeching halt. Rather, what we should see in the coming quarters is more of a mismatch between the economic cycles of the major powers.

16. ECONOMIC GROWTH IS BALANCED ACROSS REGIONS(*)

Sources: FMI and Banca March



(*) Global average since 1980.

In this context, while the Trump administration's agenda is aimed at boosting the domestic economy, in the short run the sequence of the steps taken is relevant: as public spending cuts and higher tariffs are being prioritised in the early stages of Trump 2.0, US growth will slow more than expected in the short term. However, let's not forget the positive momentum of the US economy after growing 2.8% last year and that, moreover, the current measures being implemented are likely to precede the also announced tax cuts and laxer regulations. Therefore, we believe that US GDP will still grow by more than 2% this year.

By contrast, the euro area, which started this year from a relatively weaker starting point and must also contend with the impact of the US tariff hikes, has taken a U-turn in its fiscal and monetary policies that could boost growth as we head into the second half of the year. Therefore, we are upgrading our growth estimates for the region, which, if a ceasefire in Ukraine is agreed and the implementation of fiscal stimulus in Germany is confirmed, could see GDP growth approaching the 1.5% zone in the latter half of 2025.

Looking across to China, we can make out various countervailing forces: first, aggressive tariff hikes from the United States and weaker global trade in goods will weigh heavily on economic activity over the coming months. However, the Chinese authorities have just announced new stimulus measures and have maintained their +5% growth target for this year. In our view, the economy will continue to slow gradually (GDP growth of 4.5%), seeking a new point of equilibrium with less dependence on the foreign sector and real estate, while consumption and higher value-added industries will gain in prominence.

CENTRAL BANKS

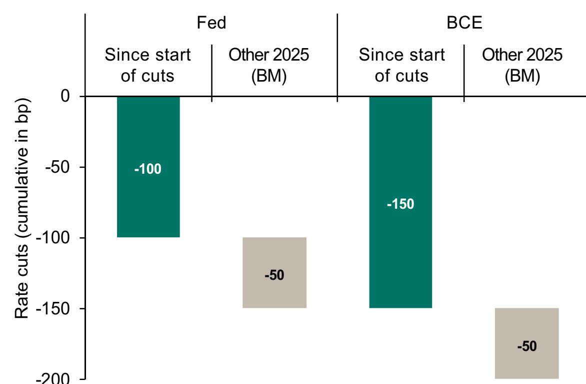
After some steeper rate cuts in the euro area, we are now entering a new phase in which the Fed and the ECB will move ahead at similar speeds. We continue to expect two further official rate cuts in the euro area and the United States for the remainder of the year.

Following the rate cut made by the ECB in March, the focus will now turn to the strong fiscal impulse that will come mainly from Germany and place pressure on the +2% inflation target.

The Fed has been taking a breather since December and in our view it is in no mad hurry to cut rates again. Despite the threat of a tariff war, the economy has taken only a slight knock so the monetary authority has room to manoeuvre and, in the hypothetical case of a further deterioration in financial conditions, could bring forward its rate cuts.

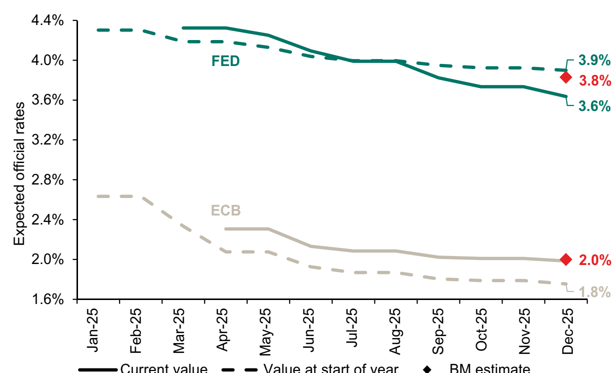
17. FED VS. ECB: RATE EXPECTATIONS

Sources: Bloomberg and Banca March



18. EXPECTATIONS AS TO OFFICIAL RATES

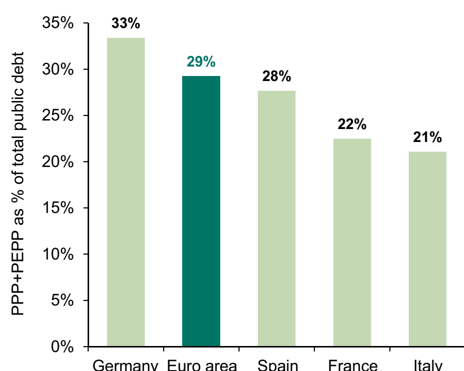
Sources: Bloomberg and Banca March



ECB: the balance sheet reduction will work against the fiscal U-turn.

19. PPP AND PEPP AS % OF TOTAL SOVEREIGN DEBT

Sources: BCE and Banca March



The European monetary authority's decision not to renew the maturities of its asset purchase programmes (APP and PEPP) will pose a further challenge when it comes to government bond issuance. Therefore, as of January this year, each country will have to find a new buyer if it wishes to issue new debt to replace the debt that has just matured, which will push up the financing costs.

It bears repeating that these two programmes largely comprise government securities and account for 41% and 25% of the monetary authority's total assets respectively.

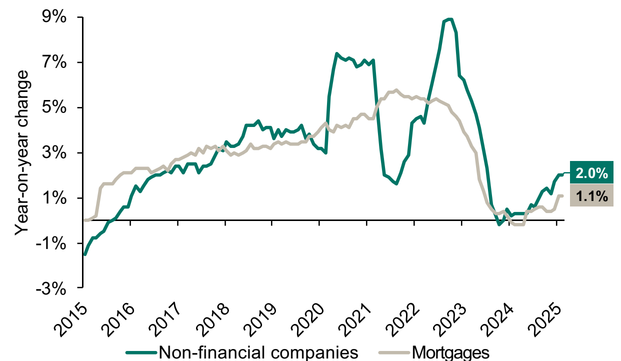
While the pace of the debt maturities at country level is unknown, according to our estimates, and assuming net purchases as a proxy for total holdings, almost one third of total German government debt looks to be held by the ECB under its APP and PEPP programmes. At euro area level, this percentage stands at around 30%.

The revival of credit will act as a support factor in the euro area.

Since early 2024, when official rates in the region were at their peak, euro area credit has made a considerable turnaround, returning once again to positive territory. We believe that, as official interest rates continue their descent, the revival of credit will play an increasingly important role and act as a brace for growth and the markets.

20. EURO AREA CREDIT PERFORMANCE

Sources: Bloomberg and Banca March



The results of the surveys that the ECB periodically conducts among private banks provide a clear example of the more propitious environment for the credit market. According to these findings, at the end of 2024, only 2% of banks claimed that prevailing interest rates had negatively affected demand for corporate credit, well below the 50% that said so at the end of 2022.

On the mortgage lending side—which accounts for 80% of total household lending—the improvement is even more striking. More precisely, just 2% of banks indicated that interest rates at the end of 2024 had negatively impacted demand, compared to around 80% two years ago.

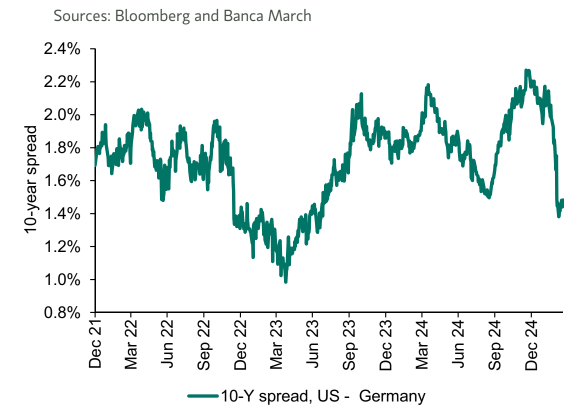
FIXED INCOME

The German fiscal U-turn and weaker macroeconomic data emerging from the US are leading to the largest decoupling of long-term rates in the last two years. In the United States, we expect the 10-year bond to reach 4% due to its safe haven status amid an environment of heightened uncertainty.

The commencement of rate cuts by the ECB, a more dovish Fed and the relative strength of the US economy have caused US long-term rates to widen their gap against European rates over the last two years. However, this situation is now rapidly changing. First, the paradigm shift that Germany is now initiating will continue to exert upward pressure on yields. Meanwhile, in the US, weaker growth figures, coupled with all the hubbub generated by Musk and his infamous DOGE, are the main drivers of the recent rally in US bond prices. Both these factors have rapidly narrowed the spread.

21. 10-YEAR RATE SPREAD (US-GERMANY)

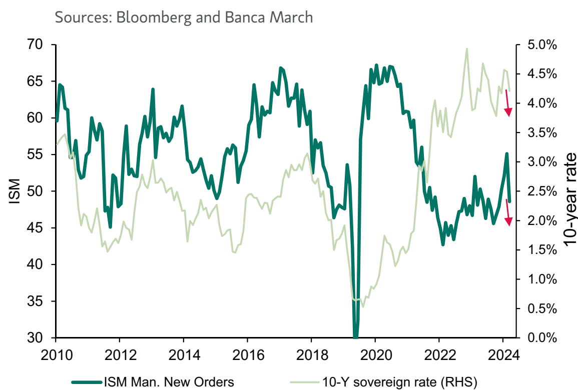
Sources: Bloomberg and Banca March



We expect this dynamic to continue in the coming months and we maintain our preference for US duration, as we wait for levels of around 4% to start profit-taking. We also happen to believe that this level would be more in line with the growing concern in the stock markets over the slowdown in US growth (the S&P has fallen by 10% from its highs).

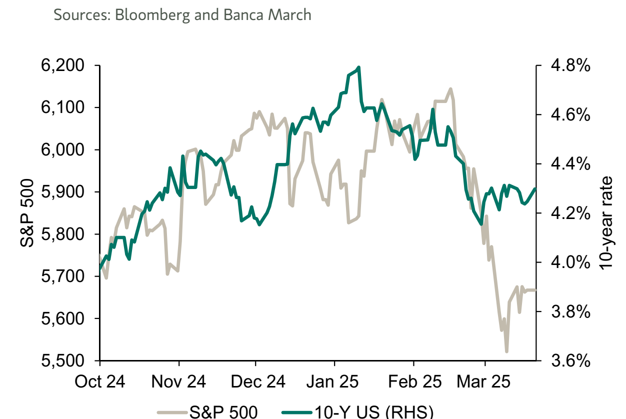
22. UNITED STATES: ISM MANUFACTURING (NEW ORDERS) VS. 10-YEAR RATES

Sources: Bloomberg and Banca March



23. UNITED STATES: S&P 500 VS. 10-YEAR RATES

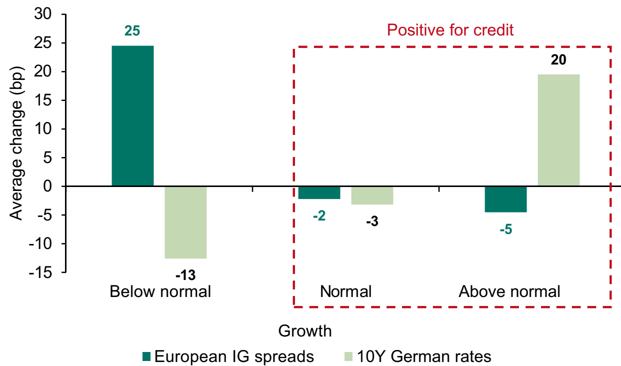
Sources: Bloomberg and Banca March



Growth in Europe will keep spreads contained on this side of the pond and lower official rates will maintain the lustre of European IG.

24. NORMAL OR ABOVE NORMAL GROWTH(*) WILL KEEP SPREADS IN CHECK

Sources: Bloomberg and Banca March



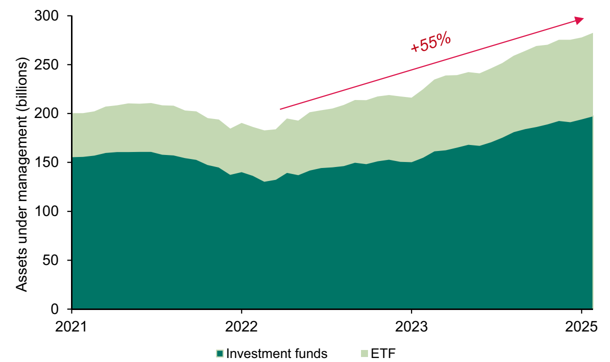
(*) Below normal: quarterly growth 1.5 times below the average of the last three years. Above normal: quarterly growth 1.5 times above the average of the last three years. Normal: everything else.

First of all, the reduction in official rates makes European high quality credit relatively more attractive. At current levels, real rates (official less inflation) will be 0% in the coming months, effectively forcing investors to look for alternatives, including European credit quality which offers an IRR of 3.3% (outpacing expected inflation by 1.3%), with relatively low risk. This will continue to increase assets under management, which have risen sharply since late 2022.

In Europe, stabilising growth should keep credit spreads stable at their current levels (90 bp), close to the lows seen before the onset of war in Ukraine. Moreover, the fact that we may see stronger growth given the paradigm shift taking place in the region should work in favour of corporate bonds, allowing them to offer better returns than sovereign debt. A clear example of this was seen in early 2025, when European high quality credit outperformed European government debt of the same duration by 0.7%, showing that, despite the recent uncertainty, IG spreads manage to remain relatively shielded.

25. INVESTMENT FLOWS TOWARD THE EUROPEAN IG SEGMENT CONTINUE TO INCREASE

Sources: Bloomberg and Banca March

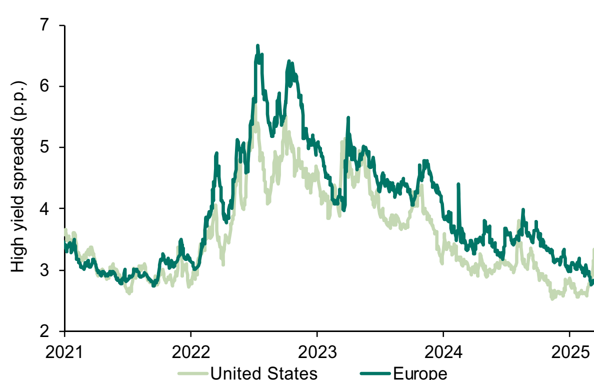


Regional balances in the HY segment are fairly even, with US spreads above European spreads for the first time since 2021. At current prices, starting yields are a pretty good approximation of what HY will command 12 months ahead. Moreover, thanks to shorter maturities and high rates, high yield debt continues to offer an attractive cushion.

After a strong performance last year, HY bond prices in both the United States and the euro area are at levels above 95 (fairly common in the last 25 years). Historically, this tends to indicate that the IRR and the 12-month yield are very close (with a small margin of error of 1% on average). In other words, in situations similar to what we are seeing now, the IRR we can observe is typically a good estimate of realised returns over the next 12 months.

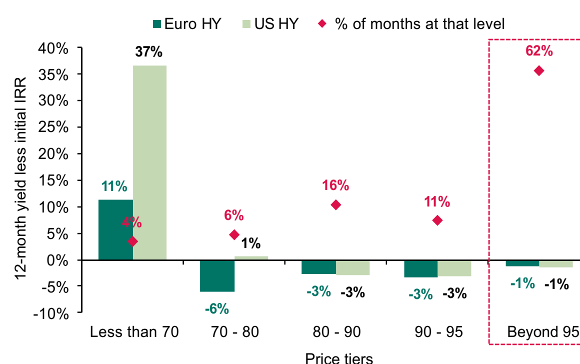
26. EURO HY SPREADS VS. HY USA

Sources: Bloomberg and Banca March



27. HY DEBT: IRR AND RETURN AT 12 MONTHS

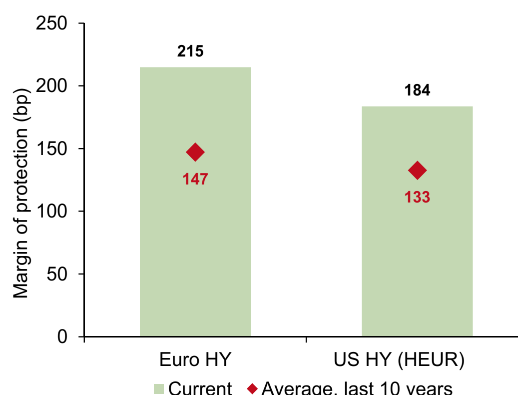
Sources: Bloomberg and Banca March



Moreover, the reduction in maturities, together with the high coupon being paid, have kept the protection margin within this fixed income segment fairly high. More precisely, the 'yield cushion'—defined as a security's yield divided by its duration—offered by the lowest quality corporate debt currently stands at 215 bp in the case of Europe, well above the 147 bp average of the last 10 years. Meanwhile, this cushion in the case of the United States stands at around 184 bp, compared to an average of 133 bp over the same period.

28. HY DEBT: YIELD CUSHION

Sources: Bloomberg and Banca March



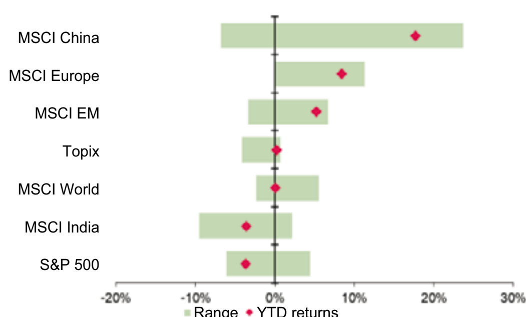
Looking at both factors, we continue to favour the HY universe as an essential complement to increase our returns, as we head through a 2025 where higher volatility must be assumed if we are to stay ahead of inflation. Moreover, in a soft landing scenario, with the global economy set to grow nominally above 5% and with Europe benefiting from the German U-turn, the risk of default (the real risk of the asset) is limited over the next few quarters. That said, we remain neutral, as spreads are still below the historical average of the last 25 years (EU 306 bp vs. 548 bp and US 302 bp vs. 513 bp).

EQUITIES

A very selective first quarter, with heavy profit-taking in “big tech” versus gains in Europe and emerging markets.

29. PERFORMANCE OF GLOBAL STOCK MARKET INDICES

Sources: Bloomberg and Banca March



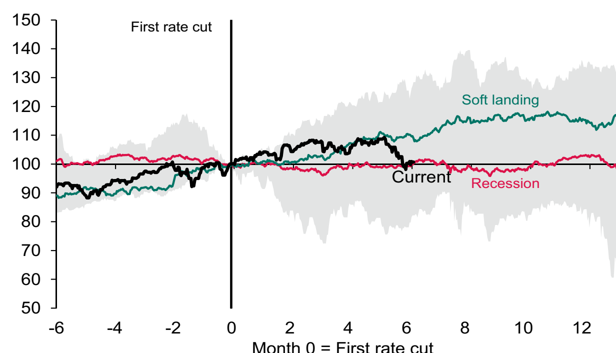
Early 2025 has brought with it increased volatility and dips within the “big tech” segment, pushing Wall Street into a brief technical correction and even into the red for the year to date. In contrast, Germany’s unprecedented fiscal turnaround, coupled with the announcement of the European ReArm plan and Chinese progress in AI, together with government stimulus policies, are shoring up their indices.

By sector, we would highlight the positive performance of energy (+6.8%), materials (+6.1%) and health (+5.8%), compared to the decline in technology just mentioned (-7.8%) and also consumer discretionary (-6.4%).

In a soft landing scenario with no indications of a recession, the downside should be limited. In the past, the stock markets almost always recovered in the same year. The “Trump put” should serve as a safety net.

30. PERFORMANCE OF THE S&P 500 FOLLOWING THE RATE

Sources: Bloomberg and Banca March



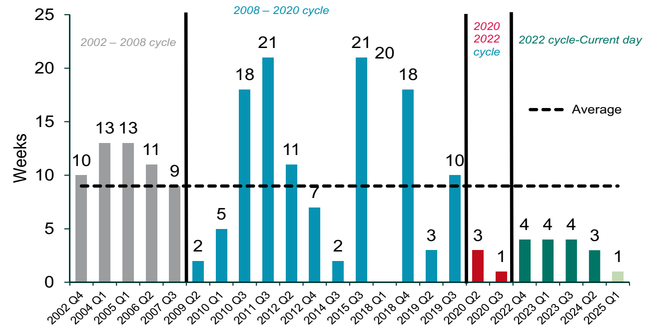
Looking at historical patterns, equities have risen by an average of 17% in the 12 months following the first interest rate cut, provided there is a soft landing of the economy (green line). However, the belligerent stance being taken by the new administration on the tariff front, coupled with the unpredictability of some of its measures, have stoked fears of a recession within the stock market, which we do not believe will happen. A slowdown is one thing, as some of the indicators we track do indeed show, but a recession is quite another.

It bears repeating that downward corrections of more than 10% within the year—such as what we are now seeing—are fairly common (38% of the last 44 years) and moreover the markets recover in the same year in 70% of cases. In our view, the uptrend in the S&P 500 remains intact and what we are seeing is the market undergoing a correction as it factors in the risk of slower economic growth. As we see no signs of a recession, we are inclined to believe that, even in the worst case scenario, we would not see a bear market, which would imply downward corrections of more than 20%.

If we look more closely at recent stock market cycles, these episodes of limited dips tend to last 17 weeks on average (eight weeks to bottom out and then nine weeks to recover), although admittedly, in the recent cycle, the recoveries to highs have been shorter and have only taken four weeks on average. If the current trend continues, we should see a week of rallying as the markets shrug off the second sharpest decline of this cycle, with a decline of 7.8% from the highs in the space of four weeks.

31. DURATION OF RECOVERIES FOLLOWING DECLINES OF MORE THAN 5% IN BULL MARKETS(*)

Sources: Bloomberg and Banca March



(*) Stock market cycles in which the market does not suffer a downward correction of more than 20%.

It should also be noted that of all the 'tariff scare' episodes we witnessed back in 2018, the worst correction was -10.5%, similar to the one we have just seen. If these thresholds are persistently breached, we could see the 'Trump put' materialise, as part of his political might lies in the strong performance of the economy, with the S&P 500 being one of the most visible financial indicators and one of the most influential when it comes to consumer sentiment, mainly among those with high purchasing power, which shores up US GDP.

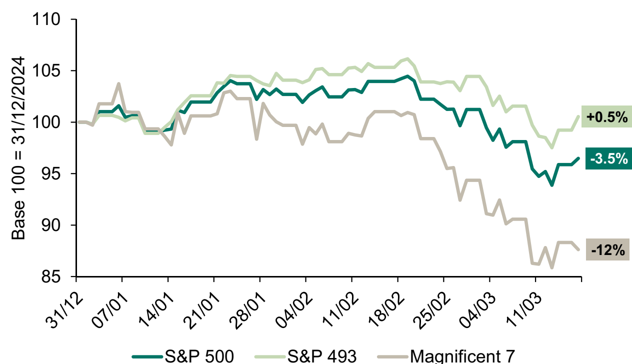
Therefore, although the stock market correction could persist over the coming weeks given the existing tariff uncertainty, it is only natural that Trump will also be concerned about the potential short-term adverse effects on the economy, and will be keen to avoid a debacle in the economic and stock market cycle.

A turbulent start to the year for the US stock market, although this does not alter the positive outlook moving forward. We maintain our favourable view on US equities.

The 10% decline from the highs that the S&P 500 reached in mid-March is a clear illustration of the uncertainty that Trump's policies are generating. The market is pricing in the short-term negative impact of the aggressive tariff hikes, their chaotic implementation and public sector spending cuts—measures that have even called into question the robustness of the US cycle—but seems to be overlooking the fact that, as we move forward in his term, we will also be seeing, before too long, catalysts for growth and thus for the stock markets (in the form of less regulation and lower taxes).

32. S&P 500 VS. S&P 493: YTD RETURN(*)

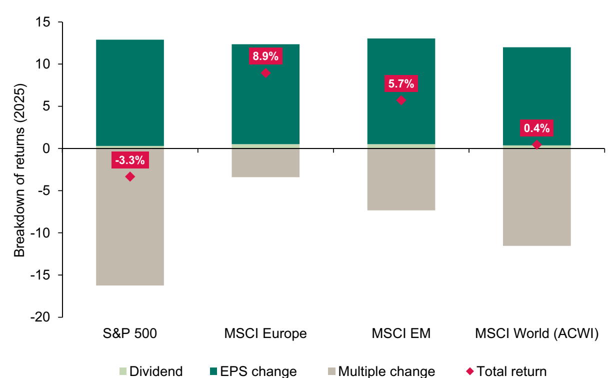
Sources: Bloomberg and Banca March



(*) S&P 500, excluding the Magnificent 7.

33. BREAKDOWN OF RETURNS BY REGION

Sources: Bloomberg, Refinitiv and Banca March



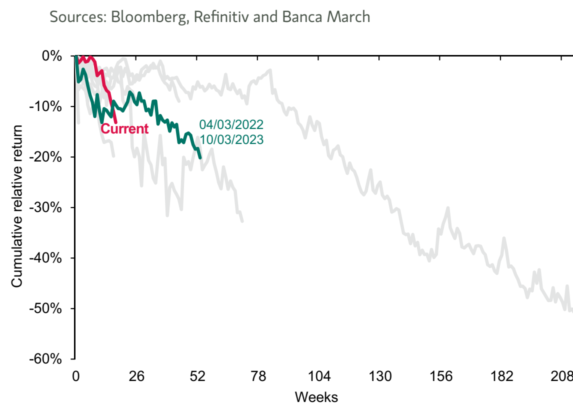
We therefore believe that the weak start to the year for the S&P 500, far from scaring us, should be put into perspective and viewed as an opportunity. As we can see in Figure 32, the current downturn conceals two very different realities: while the so-called Magnificent 7 have dragged down the US stock market and already amassed losses of -12% over the year, the remaining 493 companies have delivered a more positive performance and even achieved gains of +0.5% in the year to date.

Another factor we consider relevant is that the fall in the US stock market is largely down to a price adjustment (lower multiples) and not so much due to a deterioration in the growth prospects of corporate earnings (Figure 33). Since the start of the year, the aggregate of analysts has lowered their earnings outlook for the S&P 500 by 1.3%, a token downgrade which still allows us to foresee double-digit corporate earnings growth in 2025 (+11.5%), higher than the tally expected for Europe (+6.5%).

This is important because Q1 corporate earnings will begin to trickle in as we move into April and we could see a more sustained recovery in the stock market if, as we expect, this differential growth is confirmed.

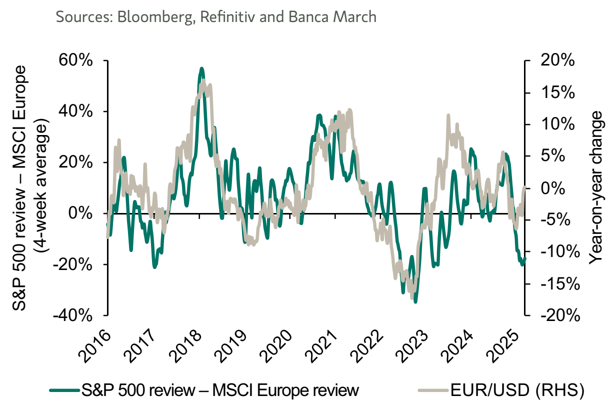
34. S&P 500 VS. EUROPE

Sources: Bloomberg, Refinitiv and Banca March



35. EARNINGS REVISION VS. EUR/USD

Sources: Bloomberg, Refinitiv and Banca March

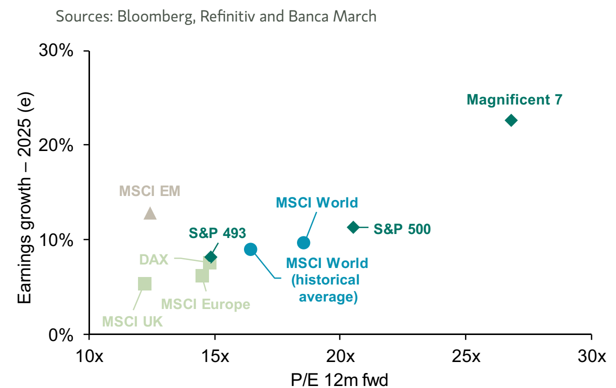


If we compare in historical terms this worse relative performance by the US stock market compared to its European counterpart, it is plain to see that the current episode is already one of the longest in duration and among the most intense (Figure 34). Therefore, we should not rush in and lower our weight in the US equities despite this turbulent start to the year. We should also consider that the recent weakness of the dollar may act as a brake on this trend: the depreciation of the dollar will make US companies more externally competitive (40% of sales at S&P 500 companies come from abroad) and a fall of 5% in the greenback (as we have seen this year) has historically led to a shift in earnings revision ratios in favour of the US stock market compared to the European one (Figure 35).

In short, we continue to prefer the US stock market and this underperformance is unlikely to continue indefinitely. North American companies will continue to report higher earnings growth rates than companies from other regions, and now at tighter valuations. Furthermore, if we adjust for the effect of the Magnificent 7, we can see that the P/E ratio of the other 493 companies is below the historical average (S&P 493 priced at 14.9x versus an average MSCI World P/E ratio of 16.4x).

36. EARNINGS GROWTH 2025 (E) VS. VALUATION

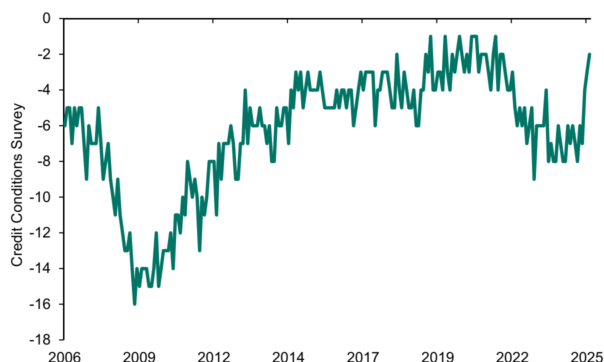
Sources: Bloomberg, Refinitiv and Banca March



We maintain our preference for small US companies. Borrowing conditions are improving and current valuations have already priced in the potentially detrimental effect of tariffs.

37. SME SENTIMENT SURVEYS FOR THE US: CREDIT CONDITIONS SURVEY

Sources: Refinitiv and Banca March



The two pillars on which our recommendation is based remain firmly in place.

One of the factors we pointed to was the improvement in credit conditions which, according to the survey on US SMEs, have indeed relaxed substantially since the start of the year, to levels close to those prior to the Fed's rate hike. In our view, this should ease the financial burden on small companies, which are more indebted than large companies (4.6x EBITDA vs. 1.5X EBITDA) and, moreover, with half of that debt arranged at variable rates.

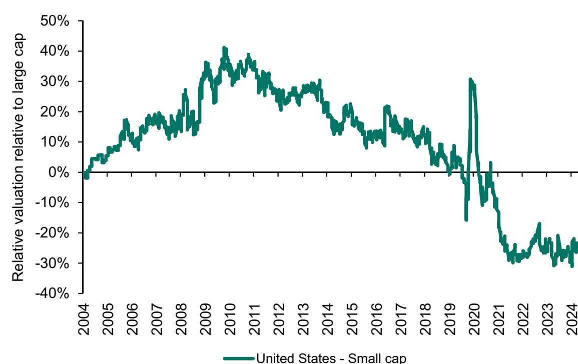
This factor will also be important in increasing volumes in corporate M&A activity, which this year is already 33% higher than last year. However, the number of deals has fallen, meaning there is still room for improvement and we believe that the arrival of Trump's tariff plan announcements, which will remove uncertainty in this regard, together with an extended improvement in borrowing conditions, should act as a catalyst for further corporate activity over the rest of the year.

Secondly, we pointed to differential growth in earnings in this segment, which still holds true, although the distance has recently narrowed (+12.5% vs. +11,5%). Significantly, however, while growth is now slightly higher, valuations continue to show a substantial discount and are still at 20-year lows, which keeps this segment looking attractive.

We believe that the recent negativity could rapidly lift as the US government's tariff plans become at least partially clearer. And any good news, such as the approval of the new Trump budgets or an upturn in economic activity, will be largely reflected in this segment.

38. RELATIVE VALUATION OF SMALL CAP VS. LARGE CAP(*)

Sources: Refinitiv and Banca March



(*) Small cap: S&P 600 / Large cap: S&P 500.

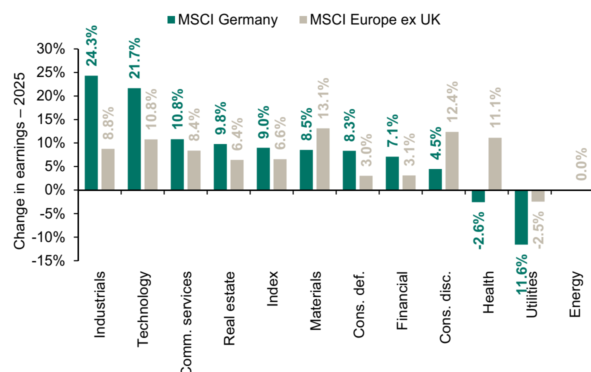
In Europe, all that glitters is not gold: Germany does indeed have the capacity to change and we see greater potential for its stock market.

European stock markets are riding high during the first quarter of 2025, despite considerable concern over the tariffs that the United States intends to impose (and about which we will know more in early April). With a 10% upturn in the year-to-date (MSCI Europe ex-UK), European equities have a definite lustre to them.

There is no shortage of reasons for this strong performance and we continue to recommend maintaining our exposure to this region. However, we do not think that all national stock exchanges are on an equal footing: in our view, Germany does have a high fiscal stimulus capacity for its domestic economy. Moreover, the sectoral composition favours a higher exposure to this specific market.

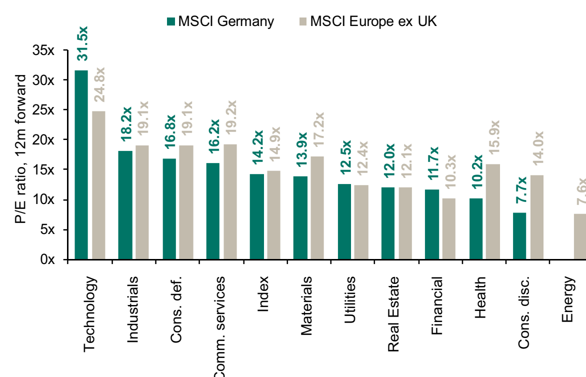
39. MSCI GERMANY VS. MSCI EUROPE EX-UK: EARNINGS GROWTH 2025 (e)

Sources: Refinitiv and Banca March



40. MSCI GERMANY VS. MSCI EUROPE EX-UK: VALUATION

Sources: Refinitiv and Banca March



The approval of the new infrastructure investment programme, coupled with higher defence spending and the relaxation of public borrowing limits are all catalysts driving an unprecedented change in Germany's recent economic history: these measures should allow corporate earnings growth to pick up to around 9% as early as this year, outpacing by almost 3 pp the expected performance for Europe as a whole (Figure 39). Against this favourable backdrop, we believe that now is a good time to favour exposure to Germany within Europe, all the more so given that in absolute valuation terms it is trading at a discount (MSCI Germany's P/E ratio is at 14.2x, below 14.9x for Europe).

Aside from these fiscal stimuli, a ceasefire and reconstruction needs in Ukraine, coupled with lower energy costs, will serve as catalysts to revive its ailing industry. This is unquestionably the leading sector for the German stock market (accounting for 23% of the MSCI Germany). It also happens to have an promising investment outlook, seeing as though, after years in the doldrums, earnings growth of 24% is now expected moving forward.

If prices drop a bit in the coming days, what with the publication of the "new" round of reciprocal tariffs on Europe by the United States, we may take the opportunity to add exposure to this economy.

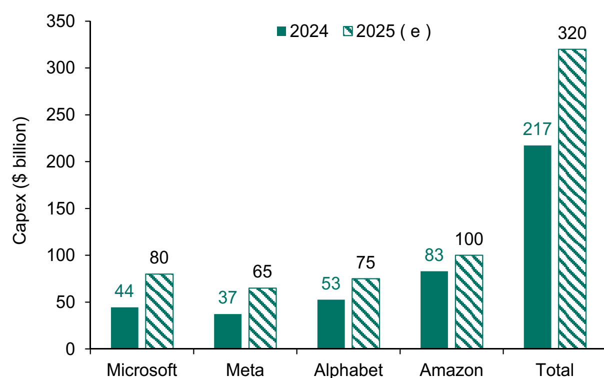
Technology corrects in the US, even though corporate earnings have risen. We remain committed to the sector because of its differential earnings growth and the role it will continue to play in the development of AI.

The recent downturn in the US technology sector has been caused by a contraction in valuations rather than a downward earnings revision. Moreover, US tech company earnings are expected to grow at a pace of 20.3% for the year—the strongest of all sectors when it comes to the growth outlook—well above the +11.5% expected for the S&P 500.

Looking at individual names, four of the big hyperscalers, namely Microsoft, Meta, Alphabet and Amazon, have announced their capital expenditure plans for this year. They will invest even more than in 2024 (+47% among them), which will continue to drive technology growth moving forward. However, we believe that cost and profitability concerns for companies will continue to rise in the aftermath of the DeepSeek saga.

47. CAPEX HYPERSCALERS(*)

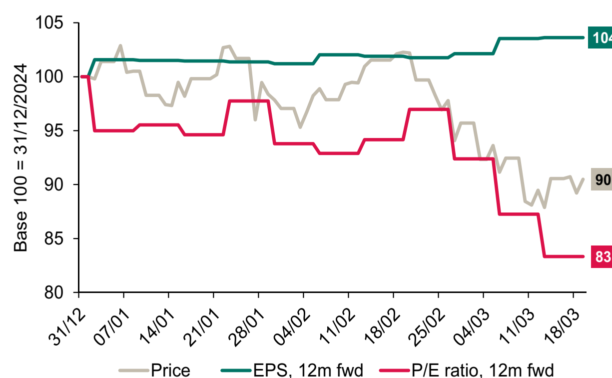
Sources: Bloomberg and Banca March



(*) 2025 (e): Capex announced by the companies for 2025.

47. S&P 500 TECHNOLOGY: PRICE, EPS AND PER PERFORMANCE(*)

Sources: Bloomberg, Refinitiv and Banca March



(*) EPS = earnings per share. PER = price earnings ratio.

We remain committed to US tech, though mainly in more defensive and less cyclical sectors such as software and cybersecurity. Software companies offer more moderate growth prospects than other segments, but with more recurring revenues, making their earnings more stable. It happens to be the only technology sub-sector with no five-year period of diminishing earnings.

Health sector: resilient and with excellent earnings prospects.

Healthcare companies turned in a very positive stock market performance in 1Q25 relative to other sectors: +6.0% YTD for the sector vs. a flat global MSCI. Underpinning this is the expectation of high and growing earnings generation in 2025, at +16.7%, the highest in almost two decades and which would make it and tech the two sectors leading the charge.

We will continue to keep a close eye on Trump 2.0, although we do not think that the healthcare sector will be hit by tariffs.

Despite positive share prices and a fairly benign backdrop, market jitters persist over the tariff uncertainty associated with Trump's return and the appointment of Robert F. Kennedy Jr. as US Secretary of Health, who is widely known for his critical stance towards the pharmaceutical industry. In our view, Trump is unlikely to slap tariffs on the healthcare sector, although it cannot be ruled out completely. There are various reasons, the main ones being that drugs enjoy certain privileges ahead of other products and there is a risk that the tariffs would lead to a shortage of drugs on the market, seeing as though there is a heavy presence of the European pharmaceutical industry in the US in terms of infrastructure, R&D, manufacturing and sales.

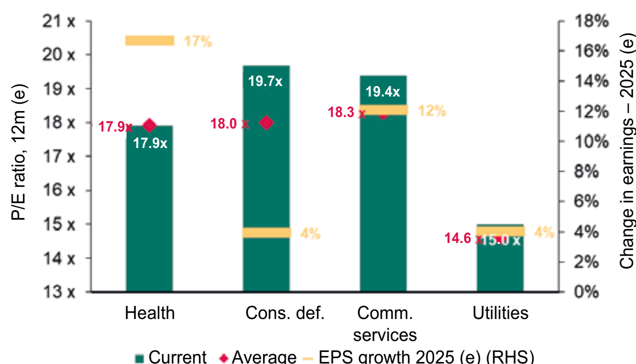
Nor do we foresee any immediate or significant changes at the regulatory level concerning the approval of vaccines, drugs or price changes in the United States, given the existing system of checks and balances in the US legal system. Ultimately, the pace and scope of the reforms will largely depend on the ability of the new leaders heading up the agencies to overcome procedural hurdles and coordinate with the multiple layers of the public administrative structure; something that will take a lot of time and effort if it happens at all.

We remain positive on the sector, which continues to trade at a discount.

We remain positive on health. The sector has a positive earnings growth profile, due to the advances seen in technology (AI), new therapies (obesity, cancer and genetics) and a potential upturn in M&A activity (following a 2024 year with no acquisitions, making it the worst in a decade), all of which goes to show the resilience and positive performance of the sector.

43. HEALTH: ATTRACTIVE VS. DEFENSIVE SECTORS

Sources: Refinitiv, Bloomberg and Banca March



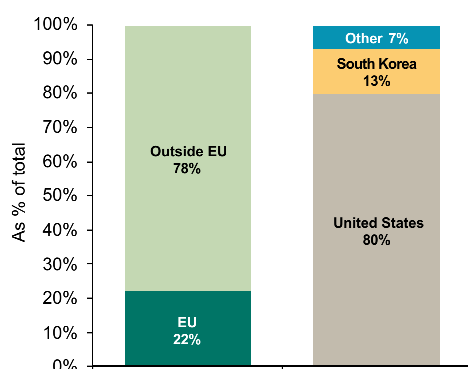
We would also recall that the strong sectoral earnings outlook is underpinned by various persistent secular factors, such as population ageing and inelastic demand, which will continue to drive innovation at a faster pace. This context provides further assurance of secular earnings growth in the sector, with an average EPS increase of 7.5% annualised between 2007 and 2026 (e), higher than the 6.5% forecast for the MSCI World over the same period. Lastly, let's not forget that among the safe haven sectors, healthcare promises the highest growth potential.

Positive on defence, with in all likelihood a substantial increase in state military spending.

After decades of dwindling military budgets, NATO allies will finally increase their contribution from 2% to at least 3% of GDP. The move implies an additional increase in military spending of at least $220 billion, with an increasing percentage of this to be channelled into materiel. It will also mean rebalancing the contribution to NATO's budget, with Europe's contribution set to climb to 42% (vs. 31% at present), coupled with a somewhat smaller contribution from the US, from 66% in 2024 to 58%.

44. REDUCING DEPENDENCE ON THE UNITED STATES WILL BE NO EASY TASK.

Sources: Bloomberg and Banca March



45. DEFENCE PER: UNITED STATES VS. EUROPE

Sources: Bloomberg and Banca March

Most of Europe's defence orders are placed with US suppliers (80% of the 78% of materiel purchases that does not come from the EU comes from the US), although we believe that listed companies in Europe stand to benefit the most from the increased spending as they concentrate their sales here, while for US defence groups Europe accounts for just 10% of their total revenues. For example, the European revenues of Germany's Rheinmetall, France's Thales or Sweden's SAAB account for 71%, 69% and 66% of their total sales.

Following the announcement of the ReArm Europe plan, we will have greater clarity in the coming months regarding the size and make-up of the spending programmes, which can be used to figure out real funding needs and growth in revenues and order books. We believe that even with a ceasefire in Ukraine, defence budgets will still grow and their growth potential has not yet fed through to earnings estimates and profit guidance. These aspects will continue to support the sector's stock market performance, despite the recent sharp rise in share prices in Europe vs. the US, and which even justify higher valuations than what we are seeing now: PER for defence stocks in Europe and the US of 25.6x and 26.4x, vs. 20.9x and 27.2x as their respective ratios during the November presidential election.

CURRENCIES

The euro has gained ground to reach 1.082 EUR/USD, following a positive start to the year for the greenback.

As happened back in 2016 following his first election victory, Donald Trump's resounding victory in the US presidential elections late last year was a boon for the dollar, which rallied to levels of 1.024 EUR/USD in early January. But since then we have witnessed a sharp turnaround, with the euro quickly achieving its highest level in five months, on the back of EU fiscal policy, a setback for American exceptionalism—DeepSeek taking the world by storm and escalating tariff tensions—, and a possible ceasefire between Russia and Ukraine. With all these factors in the cocktail shaker, the euro is climbing and is now trading at 1.082 EUR/USD, up 4% in the year to date.

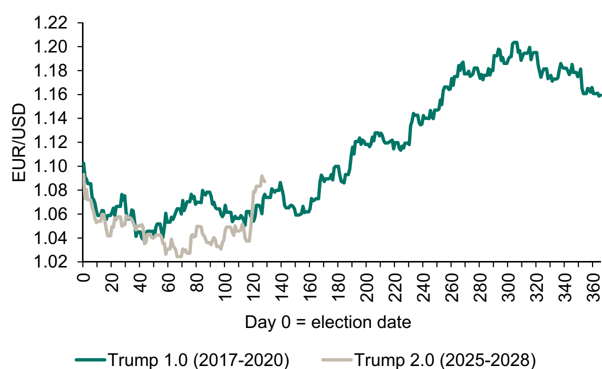
In the short term, the market's main concerns now appear to be Trump and a somewhat less prominent international role for the greenback.

As for the uncertainty over Trump's term in office, the market could once again see the "puncture" that the dollar sustained during his first term, when it reached 1.20 EUR/USD once it sensed that some of Trump's election promises would not come to fruition. And while Trump has in the past shown a preference for a "weak" dollar, his administration's actions have had mixed effects on the value of the nation's currency, illustrating the complexity of influencing global foreign exchange markets.

While the dollar still remains the main benchmark currency, its weight in international reserves has fallen 12 pp in the last quarter century, and especially since 2015, to account for 57% of total reserves. Meanwhile, the euro has been more stable and the weight of gold has also risen significantly over the same period.

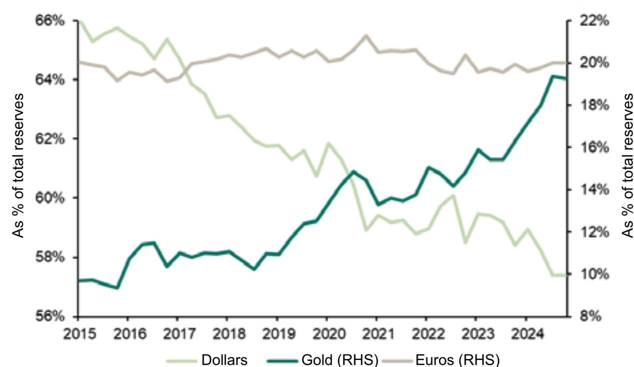
46. EUR/USD PERFORMANCE: TRUMP 1.0 VS. 2.0

Sources: Bloomberg and Banca March



47. THE $ LOSES SOME OF ITS LUSTRE AS A BENCHMARK CURRENCY

Sources: Bloomberg and Banca March



We remain neutral on the dollar, even though it is close to our buying zone, as we await better opportunities.

While the rate differential and economic growth continue to favour the United States over the euro area, the short-term aspects mentioned earlier, coupled with the fiscal imbalance of the US public accounts, may temporarily push the dollar below the 1.09 EUR/USD mark we have been targeting. However, we are waiting for a somewhat clearer picture before we move out of our neutral zone and increase our dollar exposure.

Little change for the euro-pound cross in early 2025.

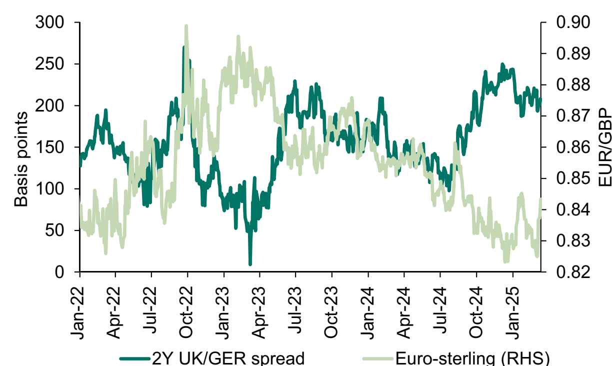
The euro has achieved a meagre 0.8% so far this year against the British currency, with the exchange rate currently at 0.836 EUR/GBP. Signs of an economic slowdown in the United Kingdom and trade tensions are currently tipping the scales in favour of the single currency, albeit without much conviction despite the announcement of significant fiscal stimulus in the euro area.

The Bank of England is still caught up in the inflation vs. growth dilemma.

The Bank of England (BoE) decided to hold interest rates at 4.5% at its recent meeting in March, adopting a cautious and less aggressive stance than the ECB. The institution headed up by Andrew Bailey is attempting to navigate the dilemma of household inflation expectations hitting a 14-month high of +3.4% and meagre quarterly growth relative to 1Q25 (+0.1%), which included a contraction in industry.

48. EURO-POUND TREND VS. 2Y UK/GER SPREAD

Sources: Bloomberg and Banca March



We maintain the range of 0.82–0.86 EUR/GBP.

Our strategy for the euro-pound is one of continuation. The expectation of fewer rate cuts in 2025 at the hands of the BoE should support the pound, although the misalignment of its public accounts and less buoyant growth raise some concerns that may weigh on the currency in the long run. We therefore think it best to sell at the high end of the range at 0.86 EUR/GBP and look for buying opportunities at 0.82 EUR/GBP.

Banca March Market Strategy Team:

Joan Bonet Majó
Pedro Sastre
Paulo Gonçalves, CAIA
Luis Coello, CFA
Juan Manuel Tealdi
Cristina Reyes Latorre

IMPORTANT REMARK:

The contents of this document are merely illustrative and do not pretend, are not and cannot be considered under any circumstances as an investment recommendation towards the contracting of financial products. This document has only been prepared to help the customer make an independent and individual decision but does not intend to replace any type of advice needed for the contracting of such products. The terms and conditions described in this document are to be viewed as preliminary terms only, subject to discussion and negotiation as well as to the agreement and final drafting of the terms affecting the transaction, which will appear in the contract or certificate to be issued. Consequently, Banca March, S.A. and its customers are not bound by this document unless both parties decide to embark on a specific transaction and agree on the terms and conditions concerning the final documents to be approved. Banca March, S.A. does not offer any guarantee, expressly or implicitly, in relation with the information shown in this document. All terms, conditions and prices contained in this document are merely informative and subject to modifications depending on the market circumstances, changes in laws, jurisprudence, administrative procedures or any other issue which may affect them. The customer should be aware that the products mentioned in this document may not be appropriate for his/her specific investment targets, financial situation or risk profile. For this reason the customer must make his/her own decisions by taking into account such circumstances and by obtaining specialised advice in tax, legal, financial, regulatory, accounting issues or any other type of information required. Banca March, S.A. does not assume any responsibility for any direct or indirect costs or loss which may result from the use of this document or its contents. No part of this document can be copied, photocopied or duplicated in any way or through any means, redistributed or quoted without a previous written authorisation by Banca March, S.A.